88-947

Supreme Court, U.S.
FILED
NOV 11 1988
JOSEPH F. SPANIOL, JR.
CLERK

No.

In the Supreme Court of the United States

OCTOBER TERM, 1988

THOMAS C. HARRISON and RITA HARRISON,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Philip W. Sandler
Attorney at Law
2640 W. Touhy Avenue,
Suite 11
Chicago, Illinois 60645
(312) 973-1122

Attorney for Petitioners

Kenneth G. Anspach, Esq.
Of Counsel

QUESTIONS PRESENTED

I Whether the "position of the United States" in a civil proceeding under 26 U.S.C. § 7430 (1982)[1] ("Section 7430") includes the position set forth by the Internal Revenue Service in a notice of deficiency.

This question has been answered in the affirmative by the United States Courts of Appeals for the First, Second, Fifth, Sixth and Ninth Circuits; it has been answered in the negative by the Eighth, Tenth, Eleventh and District of Columbia Circuits. Although the issue was

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[1] Section 7430 has been amended by §714(c) of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 and § 1551 of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085. Even though the statute has been amended, the phrase "position of the United States in the civil proceeding" is unaffected. See 26 U.S.C. §7430(c)(4)(A)(1986); Weiss v. Commissioner, 850 F.2d 111, 116 and Smith v. United States, 850 F.2d, 242, 246 (5th Cir. 1988).

presented from the lower court in this case, it was not decided by the United States Court of Appeals for the Seventh Circuit.

II Whether it is unreasonable under Section 7430 for the Internal Revenue Service to arbitrarily issue a notice of deficiency, without any basis in fact or law, for the sole purpose of protecting itself from the expiration of the statute of limitations.

III Whether the amount of litigation costs to be awarded under Section 7430 in this case includes all of the taxpayers' attorney's fees and costs incurred in the Tax Court, the United States Court of Appeals and this Court.

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OPINIONS BELOW

The opinion of the Seventh Circuit Court of Appeals in this case is reported at 854 F.2d 263 and is set forth in Appendix A. The opinion of the United States Tax Court is reported at T.C. Memo 1987-52, Tax. Ct. Mem. Dec. (CCH) 52 TCM 1503 and is set forth in Appendix B.

JURISDICTION

The decision sought to be reviewed was entered by the United States Court of Appeals for the Seventh Circuit on August 15, 1988. Jurisdiction to review the decision of the Court of Appeals by writ of certiorari is conferred on this Court under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The following statute is involved in this case:

26 U.S.C. (Internal Revenue Code of 1954, as amended) § 7430

AWARDING OF COURT COSTS AND CERTAIN FEES

(a) IN GENERAL - In the case of any civil proceeding which is-

(1) brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, and

(2) brought in a court of the United States (including the Tax Court),

the prevailing party may be awarded a judgment for reasonable litigation costs incurred in such proceeding.

(b) LIMITATIONS -

(1) Maximum Dollar Amount - The amount of reasonable litigation costs which may be awarded under subsection (a) with respect to any prevailing party in any civil proceeding shall not exceed $25,000.

(2) Requirement That Administrative Remedies Be Exhausted - A judgment for reasonable litigation costs shall not be awarded under subsection (a) unless the court determines that the prevailing party has exhausted the administrative remedies available to such party within

the Internal Revenue Service.

(3) Only Costs Allocable To The United States - An award under subsection (a) shall be made only for reasonable litigation costs which are allocable to the United States and not to any other party to the action or proceeding.

(4) EXCLUSION OF DECLARATORY JUDGMENT PROCEEDINGS -

(A) IN GENERAL - No award for reasonable litigation costs may be made under subsection (a) with respect to any declaratory judgment proceeding.

(B) EXCEPTION FOR SECTION 501(c)(3) DETERMINATION REVOCATION PROCEEDINGS - Subparagraph (A) shall not apply to any proceeding which involves the revocation of a determination that the organization is described in section 501(c)(3).

(c) DEFINITIONS - For purposes of this section -

(1) Reasonable Litigation Costs -

(A) In General - The term "reasonable litigation costs" includes -

(i) reasonable court costs,

(ii) the reasonable expenses of expert witnesses in connection with the civil proceeding,

(iii) the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the party's case, and

(iv) reasonable fees paid or incurred for the services of attorneys in connection with the civil proceeding.

(B) ATTORNEY'S FEES - In the case of any proceeding in the Tax Court, fees for the services of an individual (whether or not an attorney) who is authorized to practice before the Tax Court shall be treated as fees for the services of an attorney.

(2) PREVAILING PARTY -

(A) In General - The term "prevailing party" means any party to any proceeding described in subsection (a) (other than the United States or any creditor of the taxpayer involved) which -

(i) establishes that the position of the United States in the civil proceeding was unreasonable, and

(ii)(I) has substantially prevailed with respect to the amount in controversy, or

(II) has substantially prevailed with respect to the

most significant issue or set of issues presented.

(B) DETERMINATION AS TO PREVAILING PARTY - Any determination under subparagraph (A) as to whether a party is a prevailing party shall be made -

(i) by the court, or

(ii) by agreement of the parties.

(3) CIVIL ACTIONS - The term "civil proceeding" includes a civil action.

(d) MULTIPLE ACTIONS - For purposes of this section, in the case of-

(1) multiple actions which could have been joined or consolidated, or

(2) a case or cases involving a return or returns of the same taxpayer (including joint returns of married individuals) which could have been joined in a single proceeding in the same court,

such actions or cases shall be treated as one civil proceeding regardless of whether such joinder or consolidation actually occurs, unless the court in which such action is brought determines, in its discretion, that it would be inappropriate to treat such actions or cases as joined or consolidated for purposes of this section.

(e) Right of Appeal - An order granting or denying an award for reasonable litigation costs under subsection (a), in whole or in part, shall be incorporated as a part of the decision or judgment in the

case and shall be subject to appeal in the same manner as the decision or judgment.

(f) Termination - This section shall not apply to any proceeding commenced after December 31, 1985.

STATEMENT OF THE CASE

Petitioners, Thomas C. Harrison and Rita Harrison ("the Harrisons"), filed a petition in the United States Tax Court in order to contest the purported deficiency set forth in a notice of deficiency issued by the Respondent, Internal Revenue Service ("the IRS") prior to completion of an audit. Later, when the audit was concluded the IRS conceded that there was no deficiency due from the Harrisons. The Harrisons then sought an award of litigation costs pursuant to Section 7430 of the Internal Revenue Code, 26 U.S.C. §7430 (1982) ("Section 7430"). Their motion was denied by the Tax Court.

The Harrisons appealed the Tax Court's determination denying their motion for an award of reasonable litigation costs to the United States Court of Appeals for the Seventh Circuit. The Court of Appeals affirmed the Tax Court's denial of

litigation costs to the Harrisons. The following facts are those relied on or acknowledged by the Court of Appeals and the Tax Court in reaching their decisions and are not disputed.

During 1980, Thomas C. Harrison was a limited partner in Triangle Village Associates, Ltd. ("Triangle"), a New Jersey limited partnership. On their 1980 individual income tax return, the Harrisons reported a net loss in the amount of $47,278 representing Thomas C. Harrison's distributive share of the loss from the partnership. In addition, the Harrisons claimed an investment tax credit from Triangle in the amount of $35.

The IRS conducted an audit of Triangle's partnership tax return for the calendar years 1979, 1980 and 1981. The three (3) year statute of limitations under 26 U.S.C. § 6501(a) for the Harrisons' 1980 federal income tax return was due to expire on

April 15, 1984. On April 2, 1984, only thirteen (13) days before expiration, the IRS mailed the Harrisons a consent Form 872A, entitled "Special Consent to Extend the Time to Assess Tax," requesting an extension for the taxable year 1980 and a response within ten (10) days. Promptly, on April 4, 1984, the Harrisons executed the consent and mailed it to the IRS. The IRS never received the executed document. Without further contact, nine (9) days later, on April 11, 1984, the IRS issued a notice of deficiency in the amount of $25,347 relating to the Harrisons' 1980 federal income tax liability.

The entire amount of the deficiency determined in the notice of the deficiency arose from the IRS's summary disallowance of the Harrisons' distributive share of Triangle's loss and investment tax credit. The statement issued with that statutory notice states in pertinent part:

> The above respective claimed losses are disallowed because you have not substantiated that the entity was engaged in an activity entered into for profit or that deductible expenses were incurred by the entity in excess of its income. Furthermore, you have failed to establish any basis in the entity which would permit you to deduct an otherwise distributable loss.***
>
> *** It is determined that you failed to show that you are entitled to share in qualified investment in excess of $0 from Triangle Village Assoc.***

Unless the Harrisons timely filed a petition in Tax Court, the assessed amount plus interest would have been owed. Therefore, on June 6, 1984, the Harrisons timely filed a petition in the Tax Court seeking relief from the entire deficiency assessed for 1980. The IRS filed an answer to the petition denying all of the material allegations in the petition.

The IRS requested no further information, nor had any discussions with the Harrisons. On November 28, 1984, the IRS concluded the audit of Triangle's partnership return. It issued a "no-change" letter for the

calendar year 1980 which indicated that the return was accepted as filed and that no deficiency was found.

On December 17, 1984, the Harrisons' counsel contacted the IRS's counsel to advise him that his own client had determined that no deficiency ever existed. The December 17th communication was the first contact between the parties since the notice of deficiency was issued. Thus, the audit's conclusion that no deficiency existed was not the product of any new factual or legal information. Thereafter, the parties executed a stipulation of settled issues wherein the IRS conceded that no deficiency was ever due. In order to recover their attorney's fees and costs, the Harrisons then timely filed a motion for litigation costs pursuant to Section 7430.

In the Tax Court, the Harrisons argued, among other things, that the "position of

the United States" in a civil proceeding includes the position of the IRS set forth in a notice of deficiency because that is what engenders the action. Thus, if the IRS takes an unreasonable position in a notice of deficiency and forces a taxpayer to file suit, then the taxpayer should be permitted to recover the cost of suing.

The Tax Court limited its inquiry concerning the reasonableness of the IRS's position for purposes of Section 7430 to the post-petition phase of the case. Therefore, the court determined that even if the IRS had taken an unreasonable position in a notice of deficiency, the statute does not permit a taxpayer to recover attorney's fees and costs. The IRS conceded that the Harrisons exhausted their administrative remedies and the Tax Court found the Harrisons mailed the consent,

thus exhausting their administrative remedies.[2]

On appeal, the Harrisons again argued that the "position of the United States" in a civil proceeding includes the position set forth by the IRS in its notice of deficiency because that is what engenders the action. The Harrisons did not dispute that the IRS may issue a notice of deficiency if it needs more time to complete its audit. However, in order to do so, Section 7430 requires that it must have some reasonable basis in fact or law for determining that a deficiency could

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[2] A prerequisite for bringing an action under Section 7430 is a finding that a taxpayer has exhausted the administrative remedies available to such party. § 7430(b)(2). Refusal to execute a consent or failure to supply requested information constitutes a failure to exhaust the administrative remedies. Treas. Reg. § 301.7430-1(f)(2)(i)(1984).

exist. Furthermore, the Internal Revenue Service Manual dictates that the procedure to obtain a consent commence at least 210 days before the expiration of the statute of limitations, apparently in order to avoid any bureaucratic snafu as occurred in this case. Internal Revenue Manual (IRM), Part IV (Audit), Section 4532(1). The IRS put itself in this time constraint because it waited until thirteen (13) days before expiration of the three (3) year statute of limitations to mail a consent to the Harrisons requesting an extension. Because the Harrisons completely cooperated with the IRS, did not have any additional information which the IRS needed and did not refuse to sign the consent, issuing the notice of deficiency without any basis in fact or law for its determination, solely to circumvent the statute of limitations, was arbitrary and inherently unreasonable. The Harrisons also maintained that issuance

by the IRS of the notice of deficiency for failure to receive the consent only relates to whether the Harrisons have exhausted their administrative remedies which is a prerequisite for bringing an action under this statute and has no bearing on whether the position of the United States in the civil proceeding was unreasonable.[3]

Although the interpretation of the phrase "position of the United States" was presented for review, the United States Court of Appeals for the Seventh Circuit declined to address this issue because it found the IRS's position, both prior to and during litigation, was not unreasonable. (App. A-5 n. 3). In reaching its

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[3] If the Harrisons had refused to sign the consent or failed to supply requested information, then the IRS could adequately protect itself by arbitrarily issuing a notice of deficiency because the Harrisons did not exhaust their administrative remedies. See footnote 2.

conclusion, the court found that even the arbitrary position taken in the notice of deficiency was reasonable. The court stated:

> The Harrisons contend the IRS improperly issued a notice of deficiency arbitrarily, disallowing the Harrisons' entire loss for the sole purpose of protecting itself from the expiration of the statute of limitations. Even if this were shown to be true, it would not be an unreasonable action for the IRS to take.

The Harrisons have petitioned this Court for a writ of certiorari to reconcile the conflict among the various Courts of Appeals on the interpretation of the statute which governs the award of attorney's fees and costs to a taxpayer who has been subjected to unreasonable IRS conduct.

The statutory basis for federal jurisdiction in the United States Tax Court is 26 U.S.C. § 7442.

WHY THE WRIT SHOULD BE GRANTED

In General

This case is ripe for Supreme Court review to resolve a deep split in the United States Courts of Appeals on the interpretation of the federal law governing the award of attorney's fees and costs to a party who has substantially prevailed against the IRS. The statute in question is remedial in nature and was designed to protect taxpayers against unreasonable IRS conduct. Thus, it is important that the scope of this law be defined in order to curb the abuses Congress sought to correct. The Courts of Appeals are interpreting the same statute, and the same legislative history, in a directly conflicting manner. The decision reached in this case by the Tax Court and Court of Appeals for the Seventh Circuit creates an opportunity for the IRS to abuse the federal court system

and discriminates against those taxpayers who cannot afford to defend themselves against unreasonable IRS conduct at the initial stages of the proceedings. This Court's guidance is needed to interpret a statute which affects a significant number of taxpayers and can have a direct impact on the number of tax cases that are filed in the federal courts.

The Statute At Issue

Section 7430 governs the award of attorney's fees and costs in federal civil tax litigation. In order to recover reasonable litigation costs, the taxpayer must have "substantially prevailed with respect to the amount in controversy," or "substantially prevailed with respect to the most significant issue or set of issues presented," § 7430(c)(2)(A)(ii), and must establish that the "position of the United States in the civil proceeding was

unreasonable."[4] § 7430(c)(2)(A)(i). A prerequisite for bringing an action under Section 7430 is that the taxpayer must have exhausted the administrative remedies available to such party. § 7430(b)(2).

The Split in the Circuits

The interpretation of the scope of Section 7430 has been the subject of numerous conflicting Courts of Appeals decisions. The central issue in these cases has been the meaning of the phrase "position of the United States" in a civil proceeding for purposes of defining whether the government's conduct was unreasonable.

The First, Second, Fifth, Sixth and Ninth

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[4] Under the current version of Section 7430, the term "unreasonable" has been replaced by the phrase "not substantially justified." 26 U.S.C. §7430(c)(2)(A)(i)(1986). This phraseology has the same meaning. See Weiss, 850 F.2d at 116 and Smith, 850 F.2d at 246.

Circuits have held that in determining the reasonableness of the government's position for purposes of Section 7430, the court should consider its pre-litigation conduct. On the other hand, the Eighth, Tenth, Eleventh and the District of Columbia Circuits have concluded that inquiry must be limited only to the government's "in-court" litigation position.

The central issue in the Harrisons' and the IRS's Tax Court and Court of Appeals briefs, concerned the construction of the phrase "position of the United States" in this civil proceeding. The task of appealing the decision in this case is made more arduous because the Court of Appeals for the Seventh Circuit refused to address this issue since it found the IRS's conduct both prior to and during litigation was not

unreasonable. To date, this is the only Court of Appeals which has answered the question presented for review in this manner.

In Kaufman v. Egger, 758 F.2d 1 (1st Cir. 1985), the court held that all pre-litigation conduct can be considered in determining the IRS's liability under Section 7430. This conclusion was based on the legislative history of Section 7430 which supported the proposition that liability for attorney's fees was triggered by unreasonable IRS conduct at any stage of the proceedings. Id. at 4. The court also noted that by including pre-litigation conduct within the ambit of Section 7430, the result would be in accord with the remedial purpose of the statute and its legislative goal to deter abusive actions and overreaching by the IRS enabling taxpayers to vindicate their rights regardless of their economic

circumstances. Id., citing H.R. Rep. 97-404, 97th Cong., 1st Sess. 10, 11 (1981). As the court stated:

> It would seem to frustrate the purpose of Section 7430 if we were to interpret it in such a way that the IRS, after causing a taxpayer all kinds of bureaucratic grief at the administrative level, could escape attorney's fee liability by merely changing its tune after the initiation of a suit by the taxpayer. Kaufman, 758 F.2d at 4.

Thus, Kaufman held that unreasonable administrative conduct of the IRS can provide a basis for an award under Section 7430.

In Powell v. Commissioner, 791 F.2d 385, 392 (5th Cir. 1986), the court concluded that the civil proceeding begins once the IRS issues the notice of deficiency because the notice is what engenders the action. Thus, if a taxpayer is forced to resort to litigation by an unreasonable IRS position set forth in a notice of deficiency, then Section 7430 does not allow such conduct to be ignored. The court stated:

> The taxpayer must be the plaintiff in Tax Court proceedings. If the IRS takes an arbitrary position and forces a taxpayer to file suit, then, after the papers have been filed, becomes sweet reason, the taxpayer should be permitted to recover the cost of suing. This does not mean that the IRS position throughout the administrative proceedings need be examined; rather the inquiry should focus on the IRS's position at the time the taxpayer's petition was filed. Id. at 391-92.

The Powell court reached its conclusion by examining the recent amendments to the Equal Access to Justice Act, 28 U.S.C. §2412(d)(2)(D)(1985)("EAJA"). The 1985 amendments clarified the scope of the EAJA by providing in part:

> "['P]osition of the United States' means, in addition to the position of the United States in the civil action, the action or failure to act by the agency upon which the civil action is based. Id. (Emphasis added).

The case was remanded to the Tax Court for a determination whether the IRS's position was reasonable at the time the

petition was filed in that case. In Powell v. Commissioner, Docket No. 4565-83, 91 T.C. _____, No. 43 (filed Sept. 26, 1988) ("Powell II"), the Tax Court reconsidered the issue and concluded that the IRS's position was unreasonable pursuant to Section 7430 and the taxpayers were entitled to recover litigation costs. As the court stated:

> We recognize that respondent must take alternative or inconsistent positions at times to protect the revenue, but he may not take such position without good cause.... In the instant case, respondent's alternative position borders on being frivolous and was entirely without a legal or factual foundation. (Emphasis added).

The Second Circuit in Weiss v. Commissioner, 850 F.2d 111, 116 (2nd Cir. 1988), while noting the split in the circuits, specifically adopted the holding of the Fifth Circuit in Powell and found that a deficiency notice is the "position of the United States" if it leaves the taxpayer no alternative other than a

judicial remedy. The court, after examining the legislative history and subsequent amendments to Section 7430, concluded that since the position set forth in the notice of deficiency was unreasonable, the taxpayers were entitled to an award of reasonable litigation costs. In the case at bar, had the Court of Appeals for the Seventh Circuit interpreted Section 7430 to cover pre-litigation conduct, then this decision would be in conflict with Powell and Weiss. Here, the Court of Appeals for the Seventh Circuit found that an arbitrary position taken in a notice of deficiency is not unreasonable if the IRS needs more time to finish its work.

Kaufman and Powell, in turn, were cited favorably by the Sixth Circuit in Comer Family Equity Pure Trust v. Commissioner, 856 F.2d 775, 779-80 (6th Cir. 1988), and by the Ninth Circuit in Silwa v. Commissioner, 839 F.2d 602, 606 (9th Cir.

1988). Both courts held that the relevant inquiry should extend to the reasonableness of the behavior which forced the taxpayer to incur expenses related to the filing of a petition.

Other courts will not examine the position of the United States in a civil proceeding at the time the IRS issues a notice of deficiency no matter how arbitrary the underlying action. These courts hold that the position of the United States occurs at some unspecified time, after the answer has been filed. However, if the IRS concedes the case within a reasonable period without setting forth any position, then it has not acted unreasonably in the civil proceeding even though it was responsible for the litigation. In Ewing and Thomas, P.A. v. Heye, 803 F.2d 613, 615 (11th Cir. 1986), the Eleventh Circuit rejected the holding in Kaufman and Powell and found that the

relevant position to be examined was the government's in-court litigating position. The court stated that the denial of attorney's fees and costs may well be "unfair", but the statute as drafted was unambiguous. Id. Similarly, in Wickert v. Commissioner, 842 F.2d 1005, 1008 (8th Cir. 1988), the court, while also noting the split in the circuits, found that the position of the United States in a civil proceeding encompasses only the government's in-court litigating position. This case is in direct conflict with Weiss even though both courts relied on the legislative history and subsequent amendments to the statute. Further, the Court of Appeals for the District of Columbia, in Baker v. Commissioner, 787 F.2d 637, 641-42 (D.C. Cir. 1986) and the Court of Appeals for the Tenth Circuit, in United States v. Balanced Financial Management, Inc., 769 F.2d 1440, 1450 (10th

Cir. 1985) also interpret Section 7430 as allowing attorney's fees and costs only where the IRS has taken an unreasonable litigating position. Thus, under these cases, the position set forth by the IRS in a notice of deficiency is irrelevant.

It is clear the circuits are split on the scope of Section 7430. Given the important remedial nature of the statute which is being interpreted in a directly conflicting manner, it is submitted that certiorari should be granted on this ground alone.

Unwarranted Burdens on Taxpayers and the Federal Court System

As previously discussed, several Courts of Appeals have held that it is not unreasonable under Section 7430 for the IRS to issue a notice of deficiency without making some minimal determination on the

merits of the case.[5] Thus, in those circuits, it is permissible for the IRS to force a taxpayer to choose between paying an unfounded deficiency issued solely to circumvent the statute of limitations and filing a petition thereby incurring litigation costs. This leads to the unfortunate result that if the IRS needs more time for whatever reason, it can issue a notice of deficiency and thereafter determine whether a deficiency could even exist. In effect, the federal court system becomes one more step in the IRS's administrative process. To the extent that this practice results in the filing of additional cases by taxpayers seeking to protect themselves from unjust IRS determinations, it creates an additional burden upon an already overwhelmed federal

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[5] Meritless positions are not tolerated against the IRS nor by the courts. See 26 U.S.C. §6673 and Fed. R. Civ. P. 11.

court system.[6] The number of cases cited in this petition, alone, suggests this result is occurring with considerable frequency. Therefore, this Court should decide whether or not taxpayers must be burdened with legal costs and the federal court system with additional caseload, all as the result of arbitrary actions forcing taxpayers to litigate meritless claims.

Moreover, without the relief provided by Section 7430, those taxpayers who are arbitrarily issued a notice of deficiency, but cannot afford to contest it, are precluded from the legislative goal enabling taxpayers to vindicate their rights regardless of their economic circumstances. H.R. 97-404 at 11. This

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6 As of September 30, 1988, there were 67,491 cases pending in the United States Tax Court. Monthly Summary Report September 30, 1988, Statistics and Reports Section, United States Tax Court (Oct. 13, 1988).

preclusion is a discriminatory result which Congress sought to remedy. Furthermore, if the unfounded deficiency is relatively small, few taxpayers will contest it without the remedial relief provided by the statute.

Continued Uncertainty After Recent Congressional Consideration

At the time of preparing this petition, Congress passed the Technical and Miscellaneous Revenue Bill of 1988, which

further amended Section 7430.[7] H.R. 4333, 100th Cong., 2nd Sess. § 6239 (1988). Assuming this legislation is enacted into law, while the amendment refers to the "position of the United States" being that position taken by the IRS as of "the date of the notice of deficiency," it does not state whether the position of the United States <u>includes</u> the position taken by the

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[7] § 7430(a)(7), as amended, provides:

> POSITION OF UNITED STATES. The term 'position of the United States' means -
>
> (A) the position taken by the United States in a judicial proceeding to which subsection (a) applies, and
>
> (B) the position taken in an administrative proceeding to which subsection (a) applies as of the earlier of:
>
> (i) the date of the receipt by the taxpayer of the notice of the decision of the Internal Revenue Service Office of Appeals, or
>
> (ii) <u>the date of the notice of deficiency.</u>
>
> (Emphasis added).

IRS in such notice of deficiency. Thus, the result in this case is unaffected by the changes. Without this Court's guidance, this statute will continue to be mired in uncertainty.

Uncertainty in Amount Recoverable Under Statute

Finally, this Court has the opportunity to address the question whether the amount of litigation costs to be awarded under Section 7430 includes all of a taxpayer's attorney's fees and costs on appeal. The Tax Court in Powell II, supra, held that reasonable attorney's fees do not include those incurred in appealing a denial of a motion for an award of attorney's fees and costs. This result has a substantial chilling effect on those taxpayers who need the relief provided by the statute because it creates a disincentive for seeking the remedy provided by the statute. The

taxpayer should not be forced to engage in extensive unreimbursed litigation.

CONCLUSION

For the foregoing reasons, this petition should be granted and a writ of certiorari should be issued to review the decision below.

Respectfully submitted,

Philip W. Sandler
Attorney at Law
2640 W. Touhy Avenue, Suite 11
Chicago, Illinois 60645
(312) 973-1122

Attorney for Petitioners

Kenneth G. Anspach
Of Counsel

November 10, 1988

Appendix A

In the

United States Court of Appeals

For the Seventh Circuit

No. 87-2350

THOMAS C. HARRISON and RITA HARRISON,

Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

On Appeal from the United States Tax Court.
No. 17252-84—William M. Fay, *Judge.*

ARGUED FEBRUARY 18, 1988—DECIDED AUGUST 15, 1988

Before WOOD, JR., CUDAHY, and RIPPLE, *Circuit Judges.*

WOOD, JR., *Circuit Judge.* Petitioners-appellants, Thomas C. Harrison and Rita Harrison (the Harrisons), filed a petition in the United States Tax Court in order to contest the purported deficiency set forth in a notice of deficiency issued by respondent-appellee, Internal Revenue Service (IRS), prior to completion of an audit. When the audit was eventually concluded, the IRS conceded that there was no deficiency due from the Harrisons. The Harrisons then sought an award of litigation costs pursuant to section 7430 of the Internal Revenue Code, 26 U.S.C. § 7430. The Tax Court denied their motion. The Harrisons have appealed that denial.

I. FACTUAL BACKGROUND

During 1980, Thomas Harrison was a limited partner in Triangle Village Associates, Ltd. (Triangle), a New Jersey limited real estate partnership. On their 1980 income tax return the Harrisons reported a net loss in the amount of $47,278, representing Thomas Harrison's distributive share of the loss from the partnership. The Harrisons also claimed an investment tax credit from Triangle in the amount of $35.

The IRS conducted an examination of Triangle's partnership tax return for the calendar years 1979, 1980, and 1981. The IRS informed the Harrisons that it was auditing Triangle's 1980 tax return, and that therefore the Harrisons' tax return for 1980 was also placed under examination.

As of April, 1984, the IRS had not yet completed its audit of Triangle's partnership returns. Accordingly, on April 2, the IRS sent to the Harrisons a consent form and requested that they execute it promptly in order to extend the statute of limitations on the 1980 tax return. Absent the consent, the statute was due to expire on April 15, 1984. On April 4, the Harrisons executed and mailed the consent to the IRS. The IRS, unfortunately, never received the document. Thus, on April 11, faced with the imminent expiration of the statute of limitations, the IRS issued a notice of deficiency to the Harrisons.[1] The notice informed the Harrisons that they owed an additional $25,347 in tax for the year 1980 because the IRS was disallowing the investment tax credit and the loss deduction claimed from Triangle's activities. The notice informed the Harrisons that

> you have not substantiated that the entity was engaged in an activity entered into for profit or that deductible expenses were incurred by the entity in excess of its income. Furthermore, you have failed

[1] The IRS would no longer be able to assess a deficiency against a partner based on an uncompleted partnership audit. 26 U.S.C. § 6225.

> to establish any basis in the entity which would permit you to deduct an otherwise distributable loss.

On June 6, the Harrisons timely filed a petition in the Tax Court seeking relief from the entire deficiency assessed for 1980. The IRS filed an answer generally denying the Harrisons' allegations.

On November 28, the IRS concluded the audit of Triangle's partnership return. It issued a "no-change" letter for the calendar year 1980 which indicated that the return was accepted as filed and that no deficiency was found.

On December 17, the Harrisons' attorney contacted the IRS's counsel to advise counsel that the IRS had determined that no deficiency existed. This communication was the first between the parties since the notice of deficiency was issued. The IRS's district counsel agreed to concede the government's case against taxpayers subject to verification. During this conversation the district counsel and the Harrisons' attorney agreed to report the case as a "probable settlement" on the Tax Court's trial status report.

During the following month the district counsel verified the status of Triangle's audit and obtained a copy of the letter confirming the completion of the partnership audit without adjustment to its return. The parties then filed a stipulation with the Tax Court in which the IRS conceded the deficiency in full.

Following the IRS's concession, the Harrisons moved for litigation costs under section 7430 of the Internal Revenue Code. After holding a hearing, the Tax Court denied the Harrisons' motion on May 21, 1987. They filed notice of appeal on August 18.

II. DISCUSSION

A. Issues

The Harrisons argue that the Tax Court erred in denying their motion for litigation costs because the IRS took an unreasonable position in the civil proceeding by arbitrarily issuing the notice of deficiency. They also contend

that their litigation costs include all of their attorneys' fees and costs incurred both in the Tax Court and for this appeal. Because we affirm the Tax Court's decision, we need not reach the second issue.

B. Award of Costs under Section 7430

Section 7430 of the Internal Revenue Code authorizes an award of litigation costs to a party who substantially prevails in civil tax litigation in the federal courts.[2] In

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[2] At the time the Harrisons filed their petition, section 7430 stated in pertinent part as follows:

(a) *In general.*—In the case of any civil proceeding which is—

(1) brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, and

(2) brought in a court of the United States (including the Tax Court and the United States Claims Court),

the prevailing party may be awarded a judgment for reasonable litigation costs incurred in such proceeding.

. . . .

(c) *Definitions.*—For purposes of this section—

. . . .

(2) *Prevailing party.*—

(A) *In general.*—The term "prevailing party" means any party to any proceeding described in subsection (a) (other than the United States or any creditor of the taxpayer involved) which—

(i) establishes that the position of the United States in the civil proceeding was unreasonable, and

(ii) (I) has substantially prevailed with respect to the amount in controversy, or

(II) has substantially prevailed with respect to the most significant issue or set of issues presented.

(Footnote continued on following page)

order to be eligible for an award, the party must establish that the position of the United States in the civil proceeding was unreasonable. The Tax Court found that in determining the reasonableness of the government's position in this case, the government's in-court litigating position was dispositive.[3]

We agree with the Tax Court that the government's conduct of the litigation and the position it took was reasonable. The taxpayers have the burden of proving unreasonableness, a burden which they have failed to carry. Tax Ct. R. 232(e).

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[2] *continued*

(B) *Determination as to prevailing party.*—Any determination under subparagraph (A) as to whether a party is a prevailing party shall be made—

(i) by the court, or

(ii) by agreement of the parties.

The Tax Court found that although section 7430 has been amended by section 1551 of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2752 (1986), cases which commenced before January 1, 1986, as did this one, are governed by section 7430 as it was in effect before January 1, 1986. The current version of section 7430 defines a prevailing party as one that "establishes that the position of the United States in the civil proceeding was not substantially justified." 26 U.S.C. § 7430(c)(2)(A).

[3] The Tax Court, and the Eighth, Tenth, Eleventh and District of Columbia Circuits have analyzed section 7430 challenges in this way. *See Wickert v. Commissioner*, 842 F.2d 1005, 1008 (8th Cir. 1988); *Ewing and Thomas, P.A. v. Heye*, 803 F.2d 613 (11th Cir. 1986); *Baker v. Commissioner*, 787 F.2d 637, 641-42 (D.C. Cir. 1986); *United States v. Balanced Fin. Management*, 769 F.2d 1440, 1450 (10th Cir. 1985); *Baker v. Commissioner*, 83 T.C. 822, 827 (1984), *vacated on other grounds*, 787 F.2d 637, 641 (D.C. Cir. 1986). Other circuits have concluded that the position of the United States in a civil proceeding includes its administrative position. *See Weiss v. Commissioner*, No. 88-4017, slip op. (2d Cir. June 27, 1988); *Sliwa v. Commissioner*, 839 F.2d 602, 607 (9th Cir. 1988); *Powell v. Commissioner*, 791 F.2d 385, 390 (5th Cir. 1986); *Kaufman v. Egger*, 758 F.2d 1, 4 (1st Cir. 1985). The Seventh Circuit has not yet addressed this issue, and we need not do so here, because it appears to us that the IRS's position, both prior to and during litigation, was not unreasonable.

The Harrisons filed their petition in June, 1984, and the IRS filed its answer denying the Harrisons' allegations in July. On December 17, 1984, after being informed that the partnership's audit had resulted in a "no-change" letter, the IRS district counsel informed the Harrisons' attorney that the IRS would concede the case subject to verification. The IRS formally conceded its case within a month. The IRS took the position of conceding the case as soon as it received and verified information demonstrating that that was the proper course. This was a reasonable position. As the Eleventh Circuit reasoned in *Ashburn v. United States*, 740 F.2d 843 (11th Cir. 1984), "[t]he government should not be compelled to decide immediately upon service of the complaint whether to concede or pursue the case." *Id.* at 850 (award of fees under the Equal Access to Justice Act); *see also Ewing and Thomas, P.A. v. Heye*, 803 F.2d 613 (11th Cir. 1986) (government's litigating position reasonable when it settled case after filing suit); *White v. United States*, 740 F.2d 836, 842 (11th Cir. 1984) (government's concession of issue three months after issue raised was reasonable); *Baker v. Commissioner*, 83 T.C. 822, 828 (1984), *vacated on other grounds*, 787 F. 2d 637, 644 (D.C. Cir. 1986) (concession of a case does not automatically mean that the conceding party's position in the civil proceeding was unreasonable).

The taxpayers asserted below that the IRS acted unreasonably in failing to request information from the taxpayers between the time they filed their petition and the time the IRS conceded the case. As the Tax Court found, however, it was the Harrisons' responsibility to come forward with evidence of the IRS's error. Tax Ct. R. 142(a). They failed to do so, and seem to have abandoned this claim on appeal. The Harrisons also contended that the IRS took an unreasonable position by insisting upon verification of the status of the partnership audit before conceding the case. The Tax Court found that this argument was meritless, and we agree. The Harrisons have failed to pursue this claim on appeal. As far as the IRS's litigating position is concerned, the Harrisons have failed to

demonstrate that the IRS was less than completely reasonable in its actions.

The Harrisons on appeal seem to focus exclusively on the government's position before the Harrisons filed their petition. The Tax Court declined to rule on these prepetition arguments because of its finding that section 7430 dealt only with the government's litigation position. We discuss these arguments only briefly.

The Harrisons contend that the IRS improperly issued a notice of deficiency arbitrarily, disallowing the Harrisons' entire loss for the sole purpose of protecting itself from the expiration of the statute of limitations. Even if this were shown to be true, it would not be an unreasonable action for the IRS to take.

In *Chaum v. Commissioner*, 69 T.C. 156 (1977), the IRS issued a notice of deficiency to toll the running of the statute of limitations after the taxpayers refused to consent to an extension. The Tax Court rejected the taxpayers' arguments that the IRS's action was arbitrary and that the IRS should have the burden of proving otherwise. *Id.* at 160-64. In *Wasie v. Commissioner*, 86 T.C. 962 (1986), the Tax Court found that the IRS had acted reasonably in issuing a notice of deficiency where the taxpayer had refused to extend the statute of limitations. *Id.* at 969. In *Roberts v. Commissioner*, 62 T.C. 834 (1974), the taxpayer argued that the IRS cannot find a deficiency merely because a taxpayer does not furnish to it proof of the taxpayer's claim. The taxpayer contended that the IRS may assess deficiencies only when it has specific information that a deduction is not permitted. The Tax Court found no merit in this position, noting that "[t]axpayers have no inherent right to deductions; they are matters of legislative grace." *Id.* at 836.

Although the Harrisons apparently did not refuse to extend the statute of limitations, the Tax Court found that the IRS did not receive their consent form. Therefore, the government acted reasonably in attempting to preserve its right to conduct a full investigation before mak-

ing a final determination on whether it should allow the Harrisons' deduction.

The Harrisons suggest that *Mearkle v. Commissioner*, 838 F.2d 880 (6th Cir. 1988), supports their position that the IRS cannot arbitrarily issue a notice of deficiency and determine the facts later. We disagree. In *Mearkle*, the Commissioner relied on a proposed regulation in disallowing the taxpayers' deduction for a home office. The underlying statute limited home office deductions to "gross income" derived from the business conducted out of the home office. The proposed regulation purported to define gross income as a net figure derived after subtracting some business expenses, a definition that eliminated the deduction for the taxpayers. The taxpayers filed a petition for redetermination of the deficiency. While their petition was pending, the Tax Court released an opinion in another case finding that the proposed regulation was inconsistent with the statute. The Sixth Circuit found that the Commissioner's continued reliance on a proposed regulation "which he knew, or should have known, was patently invalid" was not reasonable. *Id.* at 883.

The circumstances here are not comparable. Rather than forcing a taxpayer to choose between acceding to a regulation that had been held to be invalid or going to the expense of contesting it, the Commissioner here simply asked for more time in order to investigate the basis of a claimed deduction. Because the IRS did not receive the Harrisons' consent to an extension of time, its action in finding a deficiency in order to toll the statute of limitations was reasonable. *Mearkle* does not suggest otherwise.

We find that even if the Tax Court had considered the IRS's prepetition position in determining whether the Harrisons were entitled to recover litigation costs under section 7430, the result would have been the same. The IRS's position throughout the parties' dealings was reasonable.

III. CONCLUSION

The Harrisons have failed to demonstrate that the IRS took an unreasonable position either before or during litigation of their claim. Therefore, we affirm the Tax Court's denial of litigation costs to the Harrisons under section 7430.

AFFIRMED.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

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Appendix B

T.C. Memo. 1987-52

UNITED STATES TAX COURT

THOMAS C. AND RITA HARRISON,
Petitioners v. COMMISSIONER OF
INTERNAL REVENUE, Respondent

Docket No. 17252-84. Filed January 22, 1987

Philip W. Sandler, for the petitioner.

Robert F. Simon, for the respondent.

MEMORANDUM OPINION

FAY, Judge: This case is before the Court on petitioners motion for litigation costs pursuant to Rule 231 and section 7430.[1] The issue is whether petitioners

[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect at the time of the commencement of this case, and all Rule references are to the Tax Court Rules of Practice and Procedure.

should be awarded reasonable litigation costs pursuant to section 7430. The parties have submitted a stipulation of services rendered by counsel for petitioners in the event we grant petitioners' motion.[2]

Petitioners Thomas C. Harrison and Rita Harrison resided in Park Ridge, Illinois, when they filed the petition herein.

Respondent issued a notice of deficiency with respect to petitioners' Federal income tax liability for taxable year 1980. The entire amount of deficiency determined in the notice of deficiency herein arose from

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[2] The parties only agreed in the stipulation of services to the amount of litigation costs incurred and paid prior to the filing of the motion. The parties agree that, in the event the motion for litigation costs is granted, petitioners are entitled to litigation costs paid or incurred in connection with the motion of litigation costs. However, the parties have not agreed as to the amount of service performed by petitioners' counsel in that regard.

respondent's disallowance of partnership losses claimed by petitioner Thomas C. Harrison in his capacity as a limited partner of Triangle Village Associates, Ltd. (herein "Triangle"), a limited partnership. Respondent had conducted an examination of Triangle's information return for 1979, 1980, and 1981. The statute of limitations under section 6501(a) for petitioners' 1980 Federal income tax return would expire on April 15, 1984. On April 2, 1984, respondent sent a Consent Form 872A -- Special Consent to Extend the Time to Assess Tax -- to petitioners requesting that they execute such form for taxable year 1980. On April 4, 1984, petitioners executed the Form 872A and mailed it to respondent. Respondent never received the executed document. On April 11, 1984, respondent issued the notice of deficiency with respect to petitioners' 1980 Federal income tax

liability. A statement issued with such statutory notice states:

> The above respective claimed losses are disallowed because you have not substantiated that the entity was engaged in an activity entered into for profit or that deductible expenses were incurred by the entity in excess of its income. Furthermore, you have failed to establish any basis in the entity which would permit you to deduct an otherwise distributable loss.***
>
> ***
>
> It is determined that you failed to show that you are entitled to a share in qualified investment in excess of $0 from Triangle Village Assoc. ***

Petitioners timely filed the petition herein on June 6, 1984. Respondent thereafter filed an answer to the petition. On December 17, 1984, petitioners' counsel notified respondent's counsel that respondent's Newark, New Jersey, District Director concluded the examination of Triangle's information return, and issued a "no-change" letter on November 28, 1984. That is to say, the examination had been

closed without adjustment. Respondent's counsel thereupon offered to concede the deficiency in the instant case pending verification of the issuance of the no-change letter and the information contained therein. The telephone call on December 17, 1984, was the first communication between counsel after the pleadings were filed. In January of 1985, after receipt of a copy of the "no-change" letter issued to Triangle, respondent executed a stipulation of settled issues, thereby conceding the amount of deficiency in the instant case.

The parties subsequently filed with the Court the stipulation of settled issue with respect to petitioners' Federal tax liability for 1980. Petitioners then filed a motion for litigation costs pursuant to section 7430. A hearing was held on petitioners' motion.

Section 7430 states, in pertinent part,[3]

> (a) In General. -- In the case of any civil proceeding which is --
>
> > (1) brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, and
> >
> > (2) brought in a court of the United States (including the Tax Court and the United States Claims Court),
>
> the prevailing party may be awarded a judgment for reasonable litigation costs incurred in such proceeding.
>
> ***
>
> (c) Definitions-For purposes of this section -
>
> ***

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[3] Section 7430 has been amended by section 1551 of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2752. However, cases which commenced before January 1, 1986, such as the instant case, are governed by section 7430 as in effect before January 1, 1986. H. Rept. 99-841, at II-802 (Conf. 1986).

(2) Prevailing party. --

(A) In general.--The term "prevailing party" means any party to any proceeding described in subsection (a) (other than the United States or any creditor of the taxpayer involved) which--

(i) establishes that the position of the United States in the civil proceeding was unreasonable, and

(ii)(I) has substantially prevailed with respect to the amount in controversy, or

(II) has substantially prevailed with respect to the most significant issue or set of issues presented.

(B) Determination as to prevailing party.--Any determination under subparagraph (A) as to whether a party is a prevailing party shall be made --

(i) by the court, or

(ii) by agreement of the parties.

Respondent concedes that petitioners had exhausted their available administrative remedies and that petitioners have substantially prevailed with respect to the amount in controversy on the most significant issue or set of issues presented in the notice of deficiency. Petitioners argue that respondent's position in the civil proceeding was unreasonable in the issuance of the notice of deficiency and in his failure to initiate communication between the parties prior to conceding the case. Petitioners argue therefore that they are entitled to an award of litigation costs pursuant to section 7430.[4]

Our inquiry herein turns on whether the position of the United States in the civil proceedings was unreasonable within the

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[4] Petitioners have made no argument that respondent's legal position is unreasonable.

meaning of section 7430(c)(2)(A)(i). We have held that the clear meaning of the specific language of the phrase, "position***in the civil proceeding," and of the statute as a whole, supported by legislative history, requires us to examine the reasonableness of respondent's position during the litigation, that is to say, from the time of the filing of the petition in this Court. Baker v. Commissioner, 83 T.C. 822, 827 (1984), vacated and remanded on other grounds 787 F.2d 637 (D.C. Cir. 1986); Ewing and Thomas v. Heye, 803 F.2d 613 (11th Cir. 1986). We followed that standard in Wasie v. Commissioner, 86 T.C. 962 (1986), and therein limited our inquiry concerning the reasonableness of the Commissioner's position to the post-

petition period of the case. Wasie v. Commissioner, supra, at 968.[5]

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[5] Petitioners have cited cases wherein the court decided that the position of the United States in the civil proceeding includes the Internal Revenue Service's position before litigation. For example, the Fifth Circuit Court of Appeals held that the inquiry should focus on the Internal Revenue Service's position at the time the petition was filed and that if the Internal Revenue Service takes an arbitrary position and forces the taxpayer to file a suit, then the taxpayer should be permitted to recover the cost of suing. Powell v. Commissioner, 791 F.2d 385 (5th Cir. 1986), remanding a Memorandum Opinion of this Court. In Kaufman v. Egger, 758 F.2d 1, 4 (1st Cir. 1985), the First Circuit held that the government's prelitigation conduct as well as its conduct in litigation-related proceedings after a suit is initiated should be considered in setting attorney's fees.

We note that the Seventh Circuit, wherein lies the appeal of the instant case; has not yet addressed this issue. In any event, we do not find the issuance of the notice of deficiency unreasonable. Wasie v. Commissioner, 86 T.C. 962 (1986). (The Commissioner's issuance of a statutory notice where a taxpayer refuses to extend the statutory period for assessment does not, per

The determination of reasonableness requires an examination of all post-petition facts and circumstances. Baker v. Commissioner, supra at 828. The factors we may consider here are:

> (1) Whether the government used the costs and expenses of litigation against its position to extract concessions from the taxpayer that were not justified under the circumstances of the case;
>
> (2) Whether the government pursued the litigation against the taxpayer for purposes of harassment or embarrassment, or out of political motivation; and
>
> (3) other factors as the Court finds relevant.

H. Rept. No. 97-404, at 12 (1981); See also DeVenney v. Commissioner, 85 T.C. 927 (1985). Furthermore, concession of a case does not mean that the conceding party's position in the civil proceeding was unreasonable. Baker v. Commissioner, supra at 828. Petitioners have the burden of proof with respect to this issue. Rule

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> se, render the notice arbitrary or invalid.)

232(e). With that in mind, we now examine the facts as established in this case to determine whether respondent's position in the civil proceeding was unreasonable under section 7430.

We first address petitioners' contention that respondent did not initiate contact with petitioners after the petition and the answer herein were filed. As respondent states in his reply memorandum of law to petitioners' motion, it was petitioners' burden and responsibility to come forward with evidence to sustain their allegation of error. Rule 142(a). That communication was not initiated between counsel for the parties is more telling of petitioners' conduct than that of respondent. We are not prepared to find respondent's failure to initiate communication between the parties after the pleadings were filed to indicate an unreasonable position in the civil proceeding. We also refuse to hold

that the insistence of counsel for respondent in obtaining verification of the "no-change" letter before conceding the case indicates an unreasonable position in the civil proceeding. The petition herein was filed on June 6, 1984. Respondent indicated his willingness to concede the case on December 17, 1984, immediately upon notification from petitioners' counsel that the transaction giving rise to the deficiency had been resolved by respondent's Newark, New Jersey, District Director, in petitioners' favor. Petitioners made much of the fact that respondent did not initiate contact with petitioners between the filing of the pleadings and the concession, and that respondent delayed in conceding the case. We note that only one month elapsed between respondent's receipt of notification of the "no-change" letter and his final concession of the case. Furthermore, we do not find

counsel's insistence on verification before final concession of the case unreasonable conduct. If petitioners' counsel relied on the issuance of the "no-change" letter, he most likely had in his possession a copy of such letter, and respondent's counsel's request of such a copy was not unreasonable.

We hold that respondent's position in the civil proceeding herein is not unreasonable and petitioners' motion for an award of litigation costs under section 7430 is therefore denied.

An appropriate order and decision will be entered.